APPENDIX M

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 95-55747, 95-56467

ALAN RICHARDS, *et al.*,

Plaintiffs-Appellants,

v.

LLOYD'S OF LONDON, *et al.*,

Defendants-Appellees.

JOHN NORTON, *et al.*,

Plaintiffs-Appellants,

v.

LLOYD'S OF LONDON, *et al.*,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of California

Appendix M

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

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MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

The Court has directed the parties to respond to the petitions seeking rehearing of the panel decision of March 6, 1997, and suggesting rehearing en banc, in this action brought to obtain relief for alleged violations of the registration and antifraud provisions of the federal securities laws. The Securities and Exchange Commission participated before the panel as *amicus curiae* by filing a brief and appearing at oral argument. The Commission submits this memorandum to respond to arguments in the rehearing petition of the defendant, Lloyd's of London, and in the *amicus* briefs supporting that petition.

DISCUSSION

The panel correctly held, as the Commission had urged, that the Lloyd's choice of forum and law clauses are void, under the antiwaiver provisions of the Securities Act of 1933 and Securities Exchange Act of 1934,[1] to the extent they preclude Lloyd's investors from pursuing whatever claims they may have under

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1. The antiwaiver provisions state:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void.

The quoted language is from Section 14 of the Securities Act, 15 U.S.C. 77n. The parallel provision in Section 29(a) of the Exchange Act, 15 U.S.C. 78cc(a), is identical in all respects material to this case.

those laws. The panel correctly concluded that it need not determine whether preclusion of such claims would be contrary to public policy, since Congress has made that determination in the antiwaiver provisions. It also correctly held that even if a policy analysis were appropriate, public policy would preclude enforcement of the clauses because the remedies available under English law are not adequate substitutes for those under the federal securities laws.

In seeking rehearing of the panel's decision, Lloyd's and the amicus California Commissioner of Insurance make a number of incorrect arguments. We will address each in turn.

I. ANY "UNCERTAINTY" AS TO WHETHER LLOYD'S SOLD SECURITIES IS NO JUSTIFICATION FOR ALLOWING LLOYD'S TO CONTRACT AWAY STATUTORY PROTECTIONS FOR PERSONS ACQUIRING SECURITIES.

The panel expressly refrained from deciding whether the plaintiffs purchased securities. Opp. 2469-70. Instead, it "assume[d] the truth of the Names' allegation that Lloyd's was engaged in the offer and sale of securities" (Opp. 2470), noting that "[d]etermining whether the Names can prove this allegation will require further development of the record in the district court at trial or on summary judgment." Opp. 2470. Lloyd's attacks this approach with two new arguments, neither of which supports upholding the choice clauses.

Lloyd's first argues (Pet. 9) that the choice clauses cannot be overcome by "the mere assertion that the federal securities laws apply to the parties' dispute," and "the mere *allegation*"

(Pet. 9) that the plaintiffs bought a security.[2] Under this argument, presumably, the panel as a threshold matter should have required proof that Lloyd's offered and sold securities, and should have decided whether Lloyd's did so. Quite inconsistently, Lloyd's then argues (Pet. 11-13) that the panel should not be allowed to decide the question of whether Lloyd's activities involved a security — that the choice clauses should be upheld precisely because there is "uncertainty" as to whether the plaintiffs bought a security.

With respect to Lloyd's first argument — that a court must first decide whether there is a security before applying the antiwaiver provisions — a defendant who wants a court to follow that approach can raise the issue of whether there is a security when moving for dismissal or summary judgment. Lloyd's chose not to do so and the issue is not before this Court.[3]

Lloyd's second argument — that the choice clauses should be enforced if there is uncertainty about whether securities were sold — would strip persons who do purchase securities of the protections of the securities laws. If the plaintiffs purchased securities, the antiwaiver provisions protect their rights under the

2. Likewise, the dissenting member of the panel expressed concern (Op. 2481) that under the Court's decision, "just because the Appellants alleged in their complaint that they were persons acquiring any security,' United States securities law renders void the carefully written terms of the [choice clauses]. * * * An American could simply allege she had purchased a security, and thus repudiate any contractual obligations entered into around the world."

3. Lloyd's conceded before the panel that the issue of whether the Names purchased securities was "not before this Court on this appeal." Appellees' Answering Brief at 5 n.5. The Commission expresses no view on whether the Names purchased a "security" within the meaning of the federal securities laws, or whether they otherwise have valid claims under the federal securities laws.

federal securities laws. They cannot be deprived of those rights on the mere possibility that they did not buy securities. At some point in the proceedings, the plaintiffs will have to demonstrate that they did buy securities, but if the choice clauses are enforced, the plaintiffs will be denied any opportunity to do so.

II. THE ALLEGED EFFECTS THIS SUIT MIGHT HAVE ON LLOYD'S BUSINESS PROVIDE NO BASIS FOR IGNORING THE ANTIWAIVER PROVISIONS OF THE FEDERAL SECURITIES LAWS.

Lloyd's argues that a securities lawsuit would improperly impair its insurance business. It argues that allowing such a lawsuit would contravene federal policy against interference with the insurance business, and that it would frustrate the need for an international insurance business to have orderliness and predictability in the application of the law. None of Lloyd's contentions justify overriding the dictate of the antiwaiver provisions that rights under the federal securities laws cannot be waived.

A. *A Securities Lawsuit Does Not Involve Federal Regulation of the Business of Insurance.*

Lloyd's argues (Pet. 1) that the Court's decision "contravenes important federal policy of non-interference in the insurance business." This is hardly a novel argument. United States insurance companies have at times claimed that regulation under the federal securities laws is barred by the McCarran-Ferguson Act, 15 U.S.C. §1012(b), which provides that no federal law may "impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance." Lloyd's is seeking precisely the same sort of protection (*see* Pet. 11 n.6). The dissenting judge

likewise argued (Opp. 2482) that the majority "ignore[d] the century of historic success the nation's insurance lobby has enjoyed in keeping federal law largely out of the insurance business."

The Supreme Court has addressed this issue in a series of cases and has repeatedly held that federal securities regulation of the capital-raising activities and investment offerings of insurance companies is permissible since it does not involve regulating "the business of insurance" as the term in used in the McCarran-Ferguson Act. *See SEC v. National Securities, Inc.*, 393 U.S. 453 (1969) (merger of insurance companies accomplished through securities fraud); *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202 (1967) (deferred annuities having both investment and insurance features); *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959) (variable annuities having both investment and insurance features).

The Court has made clear that relations between insurance companies and their investors properly are the province of the federal securities laws. For instance, in *National Securities*, the Court referred to the McCarran-Ferguson Act as "an attempt to * * * assure that the activities of insurance companies in dealing with their *policyholders* would remain subject to state regulation." 393 U.S. at 459 (emphasis added). Since the issue in *National Securities* — alleged misrepresentations in seeking shareholder approval of a merger — implicated the relationship between an insurance company and its *stockholders*, the Court had no trouble determining that "[t]his is not insurance regulation, but securities regulation." *Id.* at 460.

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Here, as in *National Securities*, the gravamen of the complaint involves alleged securities transactions, not the insurance business. The complaint arises out of the relationship between Lloyd's and the alleged security holders from whom it raised money.

B. *Lloyd's Desire for "Orderliness and Predictability" Cannot Excuse it from Complying With United States Law When it Solicits Investors in the United States.*

Lloyd's argues (Pet. 14) that its forum selection clause not only creates 'orderliness and predictability essential to any international business transaction', but also is critical to Lloyd's ability to exercise its regulatory authority over an international insurance market with members from over eighty countries." The dissent likewise states (op. 2484):

> Subjecting Lloyd's to the varying requirements of the different countries in which Names might reside would inject counterproductive uncertainty into the operation of the Lloyd's marketplace. * * * Lloyd's structured its system to avoid this uncertainty and to create predictability through use of forum selection and choice-of-law clauses. * * * [W]ithout the certainty of the Choice Clauses, it is unlikely that Lloyd's would engage to underwrite, at premiums anyone would pay, the kind of risks in the various venues of the earth in which losses could occur.

International companies, wherever headquartered, do business in many countries of the world. Part of the "predictability" of their business planning must take into account the possibility that they will be subject to the domestic laws of

those countries. An international company that seeks to raise money in the United States cannot be surprised that the laws of the United States, including provisions that prevent waiver of the coverage of those laws, will apply to those efforts.

Moreover, it is difficult to understand how a failure to enforce the antiwaiver provisions in this private damage action would make Lloyd's conduct of its business more orderly and predictable. Regardless of whether the choice clauses are enforced, Lloyd's capital raising activities in the United States will be subject to the federal securities laws to the extent securities are offered and/or sold. Even if it were to be held that the Lloyd's Names waived their right to sue under the federal securities laws, Lloyd's would remain subject to possible law enforcement action by the Commission (or even, in appropriate circumstances, to criminal prosecution) should Lloyd's violate those laws.[4] Thus, regardless of the effect of the choice clauses, Lloyd's will have to conform its securities activities in this country to United States law. We do not understand Lloyd's to assert that it is not subject to that law.

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4. Although Lloyd's is a foreign enterprise, it is subject to the federal securities laws, and to an SEC enforcement action, so long as its activities produced the requisite "effects" within the United States, or involved the requisite "conduct" in the United States. We do not understand anyone to be making the argument that the activity of coming into the United States and soliciting investors does not have either the requisite "effects" within the United States, *see Des Brisay v. Goldfield Corp.*, 549 F.2d 133 (9th Cir. 1977); *SEC v. United Financial Group, Inc.*, 474 F.2d 354 (9th Cir. 1973), or involve the requisite "conduct" in the United States, *Grunenthal GmbH v. Hotz*, 712 F.2d 421 (9th Cir. 1983), to allow application of the federal securities laws.

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C. *The Possible Effects of a Private Securities Lawsuit on Lloyd's Business Do Not justify Ignoring the Antiwaiver Provisions of the Federal Securities Laws.*

Lloyd's and the California Commissioner of Insurance predict that if the investors are allowed to proceed with their securities claims, and are allowed to rescind their obligations under their contracts with Lloyd's, it "would 'wreak havoc' on policyholders, third-party claimants, and ceding insurers in both American and world insurance markets" (Pet. 11n.6; CCI Br. 9-14).

These predictions are based on the assumptions that if the United States Lloyd's names are allowed to sue under the federal securities laws, and if they are found to have purchased securities, and if they can establish that the defendants' violated the securities laws, and if a court grants relief allowing them to withdraw from their insurance obligations, there may be insufficient money to pay insured persons, or third party claimants, or other insurers.

Whatever the merits of this scenario — and we believe it is well within the discretion of a district court effectively to deal with the concerns raised[5] — the proper solution is not to be found in ignoring the antiwaiver provisions, upholding the choice clauses, and preventing the assertion of securities claims. Nothing in the antiwaiver provisions suggests that purchasers must be held to waive their rights to sue if the effect on defendants would be severe.

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5. The California Insurance Commissioner states (CCI Br. 12) that the interests of defrauded stockholders and of policyholders could be reconciled. It is difficult to see why the same would not hold true for claims by defrauded purchasers of other types of securities.

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A broad decision that the choice clauses are valid would, moreover, have sweeping effects far beyond the atypical facts of this case. Such a decision would, for example, deprive investors who are offered or sold stock in a foreign insurance company, and who agree to contractual provisions like the choice clauses, of their rights under the federal securities laws. Yet the California Insurance Commissioner concedes (Br. 12) that suits by such stock purchasers would not present the risks to policyholders he predicts here.

The effects this securities suit might have on Lloyd's business cannot be used as a basis to compel the plaintiffs to forgo their rights under the federal securities laws. *Cf. Tcherepnin v. Knight*, 389 U.S. 332, 346 (1967) (argument that "petitioners, if they are successful in their suit for rescission, will gain an unfair advantage over other investors" in liquidation "at best, is a *non sequitur*" that does not warrant finding they did not purchase securities).

III. THE SUPREME COURT'S HOLDING IN *SCHERK* IS NOT CONTRARY TO THE PANEL'S DECISION, AS LLOYD'S ASSERTS.

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974), is not controlling. *Scherk* involved only the enforceability of a choice of forum clause, not the situation presented here where a choice of forum clause and a choice of law clause operate in tandem to depriver investors of their statutory rights. The *Scherk* Court specifically noted that the case — upholding an agreement to arbitrate securities claims — did not present a situation where an arbitration agreement designating "arbitration in a certain place might also be viewed as implicitly selecting the law of that place to apply to that transaction," since the parties' agreement specified that it would be construed in accordance with Illinois law. *See*

417 U.S. at 519 n.13.[6] As the Court later explained in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 229 (1987)

> The decision in *Scherk* thus turned on the Court's judgment that under the circumstances of that case, arbitration was an adequate substitute for adjudication as a means of enforcing the parties, statutory rights. *Scherk* supports our understanding that *Wilko* [*v. Swan*, 346 U.S. 427 (1953)] must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue.

Here, the courts of England would *not* provide an adequate means of enforcing the provisions of the Exchange Act; they would not enforce them at all.

This case thus presents the situation the Supreme Court warned against in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985), where it cautioned that "in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy." *See also Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 115 S. Ct. 2322, 2330 (1995). While Lloyd's argues (Pet. 15-16) that *Mitsubishi* should be disregarded as inconsistent with *Scherk*, it in fact merely reinforces the fact that *Scherk* did not

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6. The Supreme Court in *Scherk*, responding to the argument of the dissent in *Scherk* that the Court's decision would "leave American investors at the mercy of multinational corporations," explicitly stated that its decision had "no bearing on the scope of the substantive provisions of the federal securities laws for the simple reason that the question is not presented in this case." *Scherk*, 417 U.S. at 518 n.12.

involve the operation of choice of law and forum clauses, working in tandem to deny plaintiffs their statutory rights under federal law.[7]

7. Lloyd's also argues (Pet. 16) that cases cited by the *Mitsubishi* Court in support of its public policy statement involved cases of prospective releases of *all* claims plaintiffs might have, while here the plaintiffs only gave up their rights under the federal securities laws, retaining rights under English law. But the cases cited by the *Mitsubishi* Court all explicitly rested on the public policy objection to plaintiffs forgoing their rights under the antitrust laws. *See Lawlor v. National Screen Service Corp.*, 349 U.S. 322, 329 (1955); *Redel's Inc. v. General Electric Co.*, 498 F.2d 95, 98-99 (5th Cir. 1974); *Gaines v. Carrollton Tobacco Board of Trade, Inc.*, 386 F.2d 757, 759 (6th Cir. 1967); *Fox Midwest Theatres v. Means*, 221 F.2d 173, 180 (8th Cir. 1955).

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CONCLUSION

For the foregoing reasons, the panel correctly held that the forum selection and choice of law clauses are rendered void by the antiwaiver provisions of the federal securities laws.

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